Role of Corporate Governance in Organization

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Abstract--Following the great financial infamy in big companies, like Enron, World Com, Adelphi, Cisco and …, one of the most issues noticed by researchers and suggested from investors is Corporate Governance, addressing the need for company management control, dividing economical unit from its ownership and improving the performance of the board of managers, auditors, accounting system, internal control, and finally maintaining investors and stakeholders' rights. Using better managers in companies results in improvement of their performance, leading to stockholders rights too; consequently financial yields will be increased and company control will be better performed. Corporate Governance importance in the world is at some extent that Standard & Poors institute has introduced following multiple criteria to measure corporate governance status: ownership structure, financial stockholders relationships, structure and how- to- act of the board of managers, and clearance and disclosure of the information. Due to the issue importance, this article will define the corporate governance and its conceptual framework, types of existed theories, types of the corporate governance, and comparing them with each others as well as attempting to develop corporate governance.

Index Terms--Corporate Governance, agency theory, transactions cost theory, stockholders theory, organization and stewardship theory.

I. Introduction

Starting the corporate governance through stocks ownership had a significant influence on company's control methods. Jensen and Mackling (1976) suggested the agency theory basics and defined the manager and stockholder as agent and employer respectively. In their analysis a stockholder is in against of a manager. One of the essential hypothesis of the agency theory is that employer and agent have opposite interests[13]. There for, separation of the governance from management resulted in an organizational problem called agency. The most original problems deal with agency is the contrast between manager and stockholder. Namely, a stockholder tries to achieve the highest step of the investment value and a manager initially tries to increase his/her own wealth. So, it is possible that the manager do not act in line with stockholder's interests [17].

Embezzlement and financial corruption of the manager and send out the stockholder's interests fro the company, are some fanatic examples of this interests contrast. This agency problem shows the need to control companies' management through their own stock holders. Nowadays, the corporate governance term is a concept being noticed and developed in the business world. Corporate governance is the foundation of the company relations with other interested groups. In general statement corporate governance is a system to control and supervise the company. Such as system determine, control, and divest the relations between a company and its stock holders. At small level, corporate governance considers achievement to company's goals, and at large level it considers optimal devotion of the society interests. Corporate governance includes a set of control mechanism in and out of the company that suitably adjust stockholders rights at one hands and the needs and the options of the board of the managers at the other hands. Finally, this mechanism provides a useful guarantee for stockholders, financial resources providers as well as other stockholders in relation with their interests' maintenance [3].

II. Corporate governance definitions

Corporate governance has been suggested as one of the most important commerce terms of the 21 the century. Analyzing the existed literature indicates that there is no definition agreed with the corporate governance system. There significant differences between the definitions of the corporate governance system based on cultural, economical, and other conditions of ach country, there for, these definitions locate in the range included from in finite views to advanced views. Term logically, "Governance" which we define it as structure and performance of a company in respect with public and private stockholders, is synonym with words like, governance, reference, supervision, and control, which their nature is accountability of managers to owners [2].

Youndong Luo writes corporate governance system, is a system governing the stock companies, and determining frameworks, wage division methods, and responsibilities, among different stack holders of the company. It also illustrates roles and procedures of deciding about the company affairs [5].

In finance and accounting literature, corporate governance is define as: "the range of control system to maintain and increase the interests of the commercial units stockholders [12]. In fact, corporate governance is a system which control procedures of the companies operating to ensure the adaptation of the manager with the stockholders' interests, are directed with. Such a system suggests the relations

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between different groups in order to determine the company's direction and performance. It also states the roles and methods, determining how/ infavor of whom the companies are governed .Corporate governance does not deal with governing the company performance, but it relates with business direction, control and supervision of the managers actions, as well as being accountability to all stockholders. Generally stated, corporate governance addresses the way of governing/controlling the companies, specially role of the board of managers in this respect, and it provides a framework for an intuitional accountability system.

Definitions of corporate governance in scientific texts have common characteristics, which one is accountability. These definitions focus on the accountability to stockholders and other stack more advanced definitions show that companies are responsible against all the society, future generations, as well as natural resources. In this view, corporate governance system deals in fact within/ex- organizational barriers, crows, and adjustment. Existed for companies, insuring that they perform their responsibility toward all the stockholders and act in all business settings in a responsive manner. Also, logic rational in this view is that stockholders' in tersest are only satisfied through considering all stockholders interests; because, companies, being responsible toward all stock holder, are of more yield and success in the long term. Companies can improve their value- making in long term, and this occurs through accomplishing their responsibility toward all stockholders, and optimizing their governance system in a suitable manner [20]. The studies conducted on corporate governance paid special attention to structure and performance of the board of managers, auditory committee, and other similar boards.

Organization and Stewardship theory: the other characteristic of the definitions is to maintain the minor stockholder rights as well as defense from stockholders and their rights. Using better managers in companies leads to improve the company performance as well as increase the stockholders rights. As a result, the company's financial yield will increase and its control will be better done. Legal and cultural issues, as well as revelation and changes in capital's market result in development of the corporate governance theory.

III. Conceptual Framework of Corporate Governance

All definitions of the corporate governance system follow common target, and it in colludes providing control on management to perform given duties and maintain stockholders' interests. Generally, these views have been resulted in suggesting theories for corporate governance system, which they include:

- Agency theory, which is in due of economical and financial issues.
- Cost theory, which is in due of economics and organization theory.
- Stockholders theory, which in due of a social view about corporate governance issue.
- Organization and Stewardship theory[4].

1) Agency theory

- Cohen et al . v…) states that previous articles on accounting, finance, and management have shown different views about corporate governance. First view, being extensively suggested in accounting and finance, focuses on agency theory [11]. Agency theory view on corporate governance has been contributed by Michel Jensen et al. (1998), supposing properties delegation and using a new definition from stock company. The main result of properties delegation in companies is separation of the companies owners from those who are responsible for daily control of companies operations; namely all the persons, having interests in an organization such as holder of the company's stocks, staffs, providers, costumers, and those who being in flounced by the organization activity[13]. This theory tries to convince managers to increase stockholders interests and the company profit instead of their own interests. In agency theory, owners delegate their companies governance to the managers, and since managers do not necessarily decide in favor of the owner, this separation will lead to appearance of agent problem and moral risk. In this respect, two hypothesis were introduced. In first hypothesis, it is stating that there is contrast between the manager and the owners, and there is no agreement between their action and the main target of the companies, being wealth increase; even though this kind of perform will be against the stockholders interests. There for, managers usually invest on the plans with short term interests, and do not pay attention to the company interests, or they incline toward the separated incomes leading to decrease of stockholders' welfare and interest value. In second hypothesis, it is suggested that owners hear some problems in confirming the managers actions. To confirm performance of managers, the following methods have been provided:
  - Using independent auditor
  - Providing voting right for stockholders in general assembly
  - Agency costs
  - Plans and coached contracts [10].

In agency theory, corporate governance has been noticed as a system and mechanism for controlling behavioral interests of the management. From agency theory prospective, performing the role of revision should be independence of managers. As a result, what is noticed more in this theory is independence of management from control and revision role. This theory deals with the case that one delegates response ability of the deciding about financial resources, or performing some services following even contract to another person. Former will be called owner (or employer) and the latter will be called agent (or executor). The relationship between stock holder and manager as well as executive manager and the managers of the different department of an organization are some examples of agency theory. Those problems being appeared from agency theory are:

- Existence of interests contrast between stockholder and manager; it means that the stockholder tries to reach to the highest investment value, and the manager tries to initially increase his/her own wealth,
- Inability of stockholder in considering manager's actions/ operations,

- Effects of in farmed an in favorable election,
- Moral risk,

In the condition of assurance lack to future occurrences, a contract between stockholder and manager is concluded. In accordance with above cases, agency theory will be effective and useful if it follows from 4 ethical principles" to avoid from damaging others, to respect others' votes, to avoid from Lying and accept agreement. Beside above cases one should consider following two actions:

- A suitable contract in which wage rate, company risks, as well as manager/stockholders shares from resulted profit have been determined.
- A suitable information/accounting system, providing necessary data based on contracts, should selected by them. In formation of this system should commonly be considerable and invaluable for both parties[1].

2) Transaction cost theory

This theory, which is an inter- course combination of economics, laws, and organization, first in the name of company behavioral theory was suggested by Cyert and March (1963), and become one of basics in industrial economic and financial theory [16]. This theory bases on a foundation that, making companies so great that they substitute with market in resources so great that they substitute with market in resources devotion. Indeed, companies are so complex and extended that they adjust market's transactions, and direct production in accordance with price flexibility of the market. Inside the companies, some transactions are removed, and the companies' managers adjust production with those transactions that they prefer themselves [9]. Transaction cost theory supposes that people often upper realistic, while the agency theory addresses the ethical risk and agency costs. Agency theory supposes that managers try to achieve diverted incomes, while in transaction cost theory, managers arrange themselves opportunistically. Other difference is that the unit of analysis in agency theory is individual, while in transaction cost theory the unit of analysis is transaction. However, both theories address one problem: how do convince the manager trying to increase company profit and stockholders' in long term rather than reach to own interests? This view focuses on managerial control [14]. In comparison with agency theory, this view states corporate governance as an inevitable variable. In revision, corporate governance has no effect, and in management dominant it is clearly a symbolic term. In fact, master managers select members of the board of managers instead of independent individual from his/her friends [15]. Members of the board of managers are as passive individual in governance procedure, and they depend on the company's managers for information about industry and company .Although, corporate governance is an appearently composed to maintain the stockholders' interests, these views are combination of both company management and board of managers, and there is no stockholder. In these theories, also there are not other stockholder or society[19].

3) Stockholders theory

This theory, being a combination of social and organizational theories, begun to develop in 1970th; it is more an extensive research, That mixes philosophy, ethics, political theories, economics, lows, organizational as well as social sciences with each other (wheeler et al). Foundation of this theory is that companies become more great, and their influence on the society is so deep that is should pay attention/accountability to much more sections of the society, having mutual interests (except stockholders); in the other words, not only stockholders are influenced by the company, but they also influence on the companies. They, in the companies, have interests rather than stocks. Stakeholders include stockholders, staffs, sellers, costumes, debaters, neighbor companies, and public restricted to conforming the managers' decisions, trying to satisfy they requiring themselves to satisfy all of the stockholders' right or in other words they are responsible against all stockholders, they will move successful in long term and the probable of reaching to determined goals will be more to them. In fact, this theory states the responsibility of the company against these members. Also, company's goal in this theory, wealth or value creation for stock holders, are satisfied through changing their stocks to goods and services. In stakeholder model, the view of agency theory is dominated. In this view, management as those individuals who depending on the board of managers are investigated to determine certain information, and here the role of the board of managers has been changed to supervisor. In this view, like agency theory, the board of managers a long with other managers arranges procedures and strategies of the commercial unit, and its focus is generally on defining new products, markets, and new technologies, as well as helping to executive management and strategic plans. As a result, it should be noted that in this view, skill, proficiency, knowledge, and ability are external resources[5].

4) Organization and Stewardship theory

This theory includes in estimations and acknowledgments that determine how to delegate power, facilities and profit of the company between owners, managers, and other stockholders via governments. Ownership structure and legal frameworks are the most basic and determining factors of the corporate governance system. Also, external factors, like, rates of investment from in/out side, global economic status, stock supply in other countries markets, and in outflow investment will affect the corporate governance in a country. In this theory, it is stated that managers are good agents in the companies. Because they try to improve the company's profits and stockholders' yields to a high level. Also, managers excite with the need to be responsible, and this makes their work better[7].

IV. Classification of the corporate governance system

According to the conducted studies, each country's corporate governance system is characteristic, and existed corporate governance systemic a country is determined by a number of internal factors, such as owner ship, economic status, legal system, government policies, and culture. Owner ship stricture and legal frameworks are the most basic and determining factors of the corporate governance system. Also, external factors, like rates of investment from in/out side, global economic status, stock supply in other countries markets, and intra boarder investment will affect the corporate governance in a country. Maybe, there are governance systems in the number of countries having such a system in common, however, all of these systems classify in two major groups.

Relational or in- organization system:

In organization governance system is a system in which confirmed companies of any country are under owner ship of a few number of major stockholders; they might be the members of founder's family or a small group of stockholders, such as creditor banks, other companies, or government. In- organization systems are also called relational systems because they have close and common relations with the companies and their major stockholders. Although, in this model so to the close relations between owners and managers there are a litter problems, but because of little separation level of the ownership and management control, the power is always being abased and minor stockholder may not be aware of the company operation. The other problem of this system is little clearance and the possibility to abuse[4].

Ex- organizational system

In this system, great companies are controlled by the managers, and stockholders have no role in company's management, and they only effect on managers' selection. This leads to separation of owner ship from management. As being seen in agency theory, there is the problem of heavy costs, exposed to the stockholder. Although, in ex-organizational system, companies are directly controlled by managers, they are indirectly under the control of the ex-organizational members, including financial institutes and individual stockholders.

Comparing two system: in in- organizational system, companies are under owner ship of stockholders; stockholders control managers but much of this control is in the hands of a small groups of them; separation between ownership and management is not occurred, and there for agency problems ore rarely seen; ownership focus is on a small group of stockholders; and there is wealth transfusing process between minor and major stockholders- In the companies' law, legislator will see a strong protection for investor, and there is also the possibility of power abusing in front of the major stockholders, while, in ex- organizational systems, great companies are under the control of managers. But in owner ship all stockholders are ex-organizational, here there are agency problems, ownership diverse, control is in the hands of a great group of stockholders, and the possibility of stockholder's democracy is considered.

V. Clearance and discloser in the corporate governance

Disclosure issue is an important section in the corporate governance. The more clear the internal operation of the company and its cash flowing is, and it is reported more accurate, the more limited will be the cases of embezzlement and bad- management for managers and major stockholders. Thus, disclosure rules must be seen as requirements of the member ship in bourse market. The important issue about disclosure is that all the effective factors on the stock's price should be reported accurately in the correct time. This information primarily includes: income list, changing in board of managers, properties' sales and buyer, owner ship percent of executive managers, and change in the company's owner ship. Other information being disclosure at next step are: the amount of the rewards for board of managers, company strategy, and the money circulation under the balance sheet. However, clearance is one of the essential factors in a corporate governance system. Clearance deals with disclosure of facts for all the stockholders. Disclosure criticizes the operation of work market hypothesis. Dis closure is a different forms of supplying information by the company through annual reports of managers' proceedings, investigation of operational and financial states of the company, cost and profit list, balance sheet, cash circulation list, and the other items. All disclosure cases locate in the content of the company risk.

VI. Corporate governance applying strategies

The articles, distributed by BAL committee, show that essential methods and strategies of applying corporate governance are included as:

1) Recognition of organizational values, traditions, performance, and other operational standards, as well as a system in which performance adaptation with above maintained cases is being guaranteed.
2) Existence of an integrated organizational strategy, in which total success of the organization and individual role in that are measures.
3) Clear appointment of decision makers and important persons, leading finally to form a hierarchy that facilitates the possibility of executive control by the board of manager.
4) Creating mechanisms that cause interaction and cooperation between executive manager, and board of managers.
5) Existence of systems for powerful internal control, including internal and independent auditory operation in addition to business risk management that acts independent from commercial operation.
6) Certain supervision, on the cases that contrast between stake holders interests is considered; Also, knowledge it as a risk creating factor. These cases include commercial relations between long loanee from banks, major stockholders, comer cial management, and other in-organizational decision makers.
7) Developing a managerial and financial rewarding system for correct financial management, intermediate management, and staffs. This encouragemantes might be in the forms of wage increase, improvement or intermediates of mental encouragement.
8) Cleared and facilitated flowing of information in/out of the organization. That corporate governance structure in different countries has significant variation says the fact that there is no way to resolve the problem related with corporate governance and structural issues. According this fact one can say that correct corporate governance could be satisfied regardless of organization's form. In

this respect, it should be considered four important forms to control the structure of each organization in order to ensure sufficiency of majors controls: supervision by board of managers, supervision by those who do not involve in operational and daily activities (headquarters supervision), line supervision in practice, and supervising duties related to risk management and independent auditory. In addition to these cases it should be ensured that key staffs in business will be appointed in appropriate with their abilities and qualifications. Other hands, it should be considered that government ownership potentially can affect strategies and goals of the organization along with internal structure of its governance[6].

VII. Conclusion

In this article, after referring to existed definitions about corporate governance, we introduce theories related to it:

1) Agency theory, resulted from economical and financial issues.
2) Transaction cost theory, resulted from economics and organizational theory.
3) Stakeholder theory, resulted from a social view about corporate governance, and
4) Agency and organization theory also, two corporate governance systems, 1) relational or in-organizational systems, and 2) ex-organizational systems, were introduced and compared with each others. After that, the strategies for application of corporate governance were provided. Finally, while the suggestion to expand corporate governance needs to restrict successful and high level managers' privileges, and lead to different challenges like economic in efficiency, minute management in different levels, and violation of laws of the free investment markets [13]; however, such a attempt to improve corporate governance is apparent in four subjects. First subject involves with organizational structure of board of managers; for example, in the case of some board of managers we should consider some restriction. Second subject is related to auditory commit. Third subject includes internal auditors selection by the auditory committee of board of managers. Fourth subject includes decreasing the differences between master managers' rewards and commercial unit's staffs. Due to carrying out the best procedures instead of legal requirements, four above subjects were stated to improve corporate governance. At high levels, managers often avoid from acceptance of the above suggestions. Generally, the need to increase the mechanisms to improve corporate governance is very sensitive.

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